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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2017/2018

BEI2114 – INTERNATIONAL ECONOMICS

(All Sections/Groups)

27 OCTOBER 2017

9.00 a.m. - 11.00 a.m.

(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of **FIVE** pages with **TWO** sections only.
Section A – Twenty (20) Multiple Choice Questions
Section B – Three (3) Structured Questions
2. Attempt **ALL** questions in both **Sections A and B**. The distribution of the marks for each question is given.
3. Answer **Section A** in the MCQ answer sheet provided and **Section B** in the answer booklet provided.

SECTION A: MULTIPLE CHOICE QUESTIONS (25 MARKS)

1. Suppose Mexico can produce 5 autos or 10 corn. Suppose the United States can produce 4 autos or 20 corn. If opportunity costs are constant for both countries, then
 - A) the United States has a comparative advantage in corn production.
 - B) Mexico has a comparative advantage in corn production.
 - C) the United States cannot gain from trade with Mexico.
 - D) the United States has a comparative advantage in auto production.
2. Which of the following would **NOT** be associated with the **LATE PHASE** of the product cycle?
 - A) Consumption in high income countries begins to exceed production.
 - B) Increasing share of output is moving to developing countries where abundant low skilled and semi-skilled labour keep production costs low.
 - C) Consumption continues to grow in low income countries.
 - D) There is experimentation and improvement in design and manufacturing.
3. Intra-industry trade is characterised by what two features of the industry and market?
 - A) Diseconomies of scale and homogeneous products.
 - B) Non-tariff barriers and large-scale foreign investment.
 - C) Quota auctions and low effective rates of protection.
 - D) Economies of scale and differentiated products.
4. In the case of a small country, consumer surplus
 - A) decreases less with a tariff than with an equivalent quota.
 - B) decreases less with a quota than with an equivalent tariff.
 - C) is not changed by tariffs or quotas.
 - D) decreases the same with tariffs and equivalent quotas.
5. In which way are tariffs different from quotas?
 - A) They reduce the volume of imported products.
 - B) They raise the price of the imported products to consumers.
 - C) They increase the domestic quantity supplied of the product.
 - D) They raise government revenue.
6. “Cheap foreign wages” is a poor argument for protection because it fails to recognise the importance of productivity. Which of the following does **NOT** contribute to increasing productivity?
 - A) Education and training.
 - B) Government subsidies.
 - C) Infrastructure.
 - D) Capital.

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7. A single currency area requires
 - A) mobile labour and synchronised business cycles.
 - B) immobile labour and synchronised business cycles.
 - C) immobile labour and mobile capital.
 - D) a political union.
8. When comparing the U.S. and Mexican car assembly industries, the disadvantage of higher U.S. wages is offset by
 - A) Mexican trade barriers.
 - B) trade adjustment assistance in the United States.
 - C) higher productivity in the United States.
 - D) a lower opportunity cost in Mexico.
9. Suppose the exchange rates between the United States and Canada are in long-run equilibrium as defined by the idea of purchasing power parity. If the law of one price holds perfectly, then differences between U.S. and Canadian rates of inflation would
 - A) have no effect on nominal exchange rates.
 - B) be completely offset by changes in the real exchange rate.
 - C) be completely offset by changes in the nominal exchange rate.
 - D) violate the conditions for the law of one price.
10. Which of the following economic conditions cause export growth to be a basis for faster overall economic growth?
 - A) Diseconomies of scale in production for the domestic market.
 - B) A larger-than-average service sector.
 - C) A larger-than-average manufacturing sector.
 - D) Economies of scale in production for the world market.
11. Financial capital flows could include
 - A) real estate purchases.
 - B) construction of factories.
 - C) the purchase of the physical assets and operations of a multinational corporation by another.
 - D) currency market transactions.
12. One of the distinguishing characteristics of capital mobility today is that
 - A) there are far more kinds of financial instruments than there were 100 years ago.
 - B) nations are no longer dependent on their own national savings for their investment funds.
 - C) the bulk of foreign capital flows are tied to labour flows.
 - D) currency markets play a less significant role than they did in the past.

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13. If one nation is able to produce a good at a lower opportunity cost than another, it has
- A) an absolute advantage in that good.
 - B) a comparative advantage in that good.
 - C) a productivity advantage in that good.
 - D) a technological advantage in that good.
14. Low labour standards are usually associated with
- A) nondemocratic governments.
 - B) high-income countries.
 - C) high-wage countries.
 - D) low foreign investment.
15. Greater specialisation within a country
- A) increases risks to the country.
 - B) is rarely beneficial.
 - C) creates winners and losers and raises issues about fairness.
 - D) evenly distributes benefits in the long run.
16. If a country runs a current account surplus and national private savings equals domestic investment, then the combined governmental accounts
- A) must be balanced.
 - B) must be positive.
 - C) must be negative.
 - D) could be either negative or positive, depending on the net international investment position.
17. Under a fixed exchange standard, if the domestic demand for foreign exchange increases,
- A) the central monetary authority must meet the demand out of its reserves.
 - B) the central monetary authority must increase the supply of domestic money.
 - C) the fixed exchange standard will breakdown.
 - D) inflation will increase.
18. The J-curve effect that results from currency depreciation results is due to
- A) the initial effect having positive effects on the current account balance.
 - B) the value of imports increasing by more than the value of exports at the time of devaluation.
 - C) exports and imports being totally unresponsive to changes in exchange rates.
 - D) decreases in the dollar price of imports.
19. One reason why consumers are unlikely to be too upset about tariffs is because
- A) most consumers benefit from protection.
 - B) tariffs are an inexpensive way to create jobs.
 - C) consumer losses are not real losses.
 - D) the costs are so spread out that no one pays a big share of the total.

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20. Labelling that states that a product was produced under environmentally sustainable conditions may not be an effective way to reduce pollution if
- consumers do not believe the information on the label.
 - labelling increases costs.
 - producers do not apply labels.
 - governments require labels.

SECTION B: STRUCTURED QUESTIONS (75 MARKS)

Question One (25 marks)

- (a) Given the input-output relationships in the **Table 1** below:

Table 1

| Goods | Countries | |
|-------|-----------|---|
| | A | B |
| X | 8 | 4 |
| Y | 4 | 1 |

- (i) Which country has absolute advantage in which good and why? (2 marks)
- (ii) Which country has comparative advantage in which good and why? (2 marks)
- (iii) If A is endowed with 8000 hours of labour, how much X will it produce after trade begins? How much Y? Explain. (4 marks)
- (iv) What is the allowable range on A's wages relative to B's if trade is flowing between these two countries according to comparative advantage? (2 marks)
- (b) Can a country have comparative advantage in all products? (5 marks)
- (c) Why do governments generally prefer to impose tariffs over quotas? (5 marks)
- (d) Why do countries impose protection even if it lowers economic welfare? Explain fully. (5 marks)

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Question Two (25 marks)

- (a) Compare and contrast NAFTA and the EU in terms of the types of agreements that they are, the institutions that operate under the agreement, and the long term goals of the arrangements. (15 marks)
- (b) Multinationals generally have production plants in a number of countries. Consequently, they can move production from expensive locations to cheaper ones in response to various economic developments—a phenomenon called outsourcing when a domestically based firm moves part of its production abroad. If the U.S. dollar depreciates, what would you expect to happen to outsourcing by American companies? Explain and provide an example. (10 marks)

Question Three (25 marks)

- (a) Suppose in Zurich $\text{£}/\$ = 0.5$, while in New York $\text{SF}/\$ = 2.5$, but in London $\text{£}/\text{SF} = 0.1$. (Note: SF = Swiss Franc)
- (i) Is there any arbitrage profit that could be made with a triangular arbitrage action? Describe an example of how such a profit may be earned. (8 marks)
- (ii) What would you guess about the relationship between the dollar rates and cross-rates after arbitrageurs notice this profit opportunity? (4 marks)
- (b) Explain the elasticities and absorption approaches to the Balance of Trade. What is the most notable shortcoming of these approaches? (8 marks)
- (c) What are the main reasons for deviations from Purchasing Power Parity (PPP)? Provide **FIVE (5)** reasons with a short explanation for each point. (5 marks)

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